

# In the United States Bankruptcy Court

## for the Northern District of Iowa

### Western Division

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TOD M. WULFF and  
TAMMY S. WULFF

Bankruptcy No. 95-41790XM

*Debtor(s).*

Chapter 7

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### **ORDER RE: TRUSTEE'S FINAL REPORT**

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Debtors object to the distribution of estate property as proposed in the trustee's final report. Hearing on the report and objection was held December 17, 1997 in Mason City. Larry S. Eide appeared for Habbo G. Fokkena, the trustee. Judith M. O'Donohoe appeared for debtors Tod and Tammy Wulff. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A).

The trustee proposes a pro rata distribution of estate property to nine creditors. Debtors contend that the entire distribution after payment of administrative expenses should be paid to just one creditor. The facts are these.

Between 1982 and 1985, while unmarried, Tod Wulff incurred educational loans with Great Lakes Higher Education Corp. In November 1989, while indebted to Great Lakes, Tod purchased a house. On December 23, 1989, Tod and Tammy were married. Tammy had two pre-marital debts which still existed at the time of bankruptcy. She was indebted to the University of Iowa Hospitals and Spurgeon's Bank of Louisiana.

Between 1989 and 1991, Tod incurred debt with First Security Bank & Trust Co. Some of this debt remained when the couple filed bankruptcy. On March 9, 1992, the couple changed homesteads. There is no evidence that after the marriage Tod transferred partial ownership of the first home to Tammy. However, as to the new homestead, Tammy was a joint tenant when the couple filed their bankruptcy case on September 20, 1995.

At the time of the bankruptcy filing, Tod was still indebted to Great Lakes on the student loans, and he was still indebted to First Security Bank & Trust Co. Tammy remained indebted to the University of Iowa Hospitals and to Spurgeon's Bank. These creditors, among others, were scheduled by the debtors. Also scheduled were four medical care providers from which Tammy had obtained services after her marriage, and the Eggert law firm which had provided legal services to both debtors.

Debtors claimed their home as exempt. The trustee objected, claiming that the property was not exempt to the extent of pre-acquisition debt. The debtors did not resist. An order entered sustaining the objection. The order did not state the amount of the pre-acquisition debt. That issue was settled by the parties. The Wulffs agreed to pay \$12,000 to the trustee in full satisfaction of the bankruptcy estate's claims against the property. The debtors and the trustee agreed that the \$12,000 represented "a

student loan owed to Great Lakes Higher Education Agency" (docket no. 19). The settlement money has turned out to be the only asset of the estate. With interest, the trustee holds \$12,077.55.

After payment of administrative expenses, the trustee has \$9,100.27 available for distribution to creditors holding allowed unsecured claims. He proposes a pro rata distribution to nine creditors. He recommends disallowance of three claims, only one of which is relevant to this dispute. That is a claim filed on behalf of Payco American Credits, Inc. by debtors' attorney. Payco is the collection agent for Great Lakes Higher Education Agency. Great Lakes also filed a claim. The trustee proposes a distribution to Great Lakes on its claim.

The debtors object to the distributions proposed by the trustee. They contend that all of the money available for distribution to creditors, after the payments of administrative expenses, should be paid to Great Lakes Higher Education Corp. in the amount filed by Payco.

The essence of debtors' argument is that the debtors' homestead was not exempt only to the extent of Tod's debt to Great Lakes. It was on account of this debt that the homestead objection was sustained and the settlement with the trustee was reached. The homestead was exempt from all other claims filed in the case. It would be unjust, they say, to pay the proceeds of the non-exempt homestead to creditors who, under state law, could not have subjected the home to their claims. If the trustee does so, debtors argue, the Great Lakes' claim will not be paid in full, and as it is nondischargeable, Great Lakes will continue to pursue its claim after discharge, and it will continue to pursue collection from the home as it is not exempt to the extent of its claim. In short, debtors argue that a pro rata distribution inhibits their fresh start. Debtors say that instead, the monies should be distributed to Great Lakes because the trustee's objection to the homestead exemption was "debt specific" and that the court should approve, under its equitable powers, a distribution which recognizes that.

The debtors urge the court not to follow In re Nehl, No. 97-60192W (Bankr. N. D. Iowa June 5, 1997) decided by Judge Paul J. Kilburg. In Nehl, Judge Kilburg determined that the proceeds of a homestead found non-exempt to the extent of a particular debt must be distributed pro rata among all unsecured creditors. Id., slip op. at 4.

Debtors distinguish Nehl on two grounds. First, debtors contend that pro rata distribution follows only from the avoidance of an exemption pursuant to a trustee's avoidance powers under § 544. If, on the other hand, say debtors, the trustee objects to the exemption under state exemption law, and only on behalf of a particular creditor, then the proceeds resulting from a successful exemption should be distributed to that creditor. Debtors say it is the latter circumstance which obtains here, and that in Nehl, Judge Kilburg was not presented with that issue.

There is nothing in the Nehl decision indicating that the exemption was disallowed by employment of the trustee's powers under § 544 of the Code. Judge Kilburg concluded that the trustee had standing to object to improper claims of exemption under state law. Id. at 2. I agree with that conclusion. A trustee has the authority to object to a debtor's claim of exemption if the claim is not allowable under state law. That is what Trustee Fokkena did in the Wulffs' case. His objection was not based on his avoidance powers. It does not follow, as debtors argue, that when the trustee objects to a claim of exemption based on a particular creditor's claim that the benefit that inures to the estate must be distributed to the particular creditor. Nehl so concluded. See also In re Rye, 179 B.R. 375, 378-379 (Bankr. D. Mass. 1995) aff'd, 96 F.3d 1430 (1<sup>st</sup> Cir. 1996).

Debtors contend that the nature of Great Lakes' claim requires a different result. They say that neither Nehl nor Rye involved a situation, as here, in which the particular creditor's claim which was raised

by the trustee was nondischargeable. That is perhaps an unfortunate factor in the Wulffs' case. It may lead to further action against debtors' home by Great Lakes. However, the right of a creditor to subject to its nondischargeable claim assets which were partially exempted by debtors in bankruptcy has not yet been litigated. Even if such a creditor could so succeed, such a potential outcome does not require a result different from that prescribed in Nehl. The distribution scheme is pro rata. 11 U.S.C. § 726(b); In re Rye, 179 B.R. at 379. All of debtors' interests are property of their estates. If they cannot exempt an interest, it remains property of the estate. To the extent it does, the trustee's obligation is to distribute the liquidated proceeds pro rata. If the trustee were forced to administer the asset on behalf of Great Lakes, it would elevate Great Lakes' claim from unsecured to secured, essentially giving Great Lakes a lien which it does not have. To the extent Great Lakes has allowable claims, it may share in the assets of the estates. A determination of its ability to pursue the homestead after bankruptcy must be left to another day.

I conclude that the monies included in the Wulffs' bankruptcy estate by virtue of the trustee's objection to the homestead exemption must be distributed pro rata among unsecured creditors. The debtors' objection to this aspect of the trustee's final report is overruled.

This does not end the inquiry. The parties do not agree as to the calculation of the distribution. I conclude that the trustee's proposed distribution cannot be approved.

There are two estates, one for each debtor. The filing of a joint petition and joint administration of estates does not consolidate them. Issues may remain as to the amount of proceeds, if any, in each estate and as to what claims are allowable in each case. The claims are not identical in each case. It would be premature for me to decide now how the proceeds should be distributed. The trustee's present report gave notice to parties of a proposed distribution. It would be inappropriate for me to decide on a final distribution when creditors have not had notice of it nor an opportunity to object.

The trustee must amend his final report. He should consider the extent of each debtor's rights in the proceeds of his settlement, and he should consider each claim to determine in which estate each is allowable. These considerations may require consideration of aspects of Iowa law not heretofore considered, such as when one spouse is liable for a debt of the other (see Iowa Code § 597.14); and the nature of jointly held property (see Frederick v. Shorman, 147 N.W.2d 478, 482 (Iowa 1966) (presumption that joint tenants hold in equal shares)). Last, he must determine a distribution calculation which gives fair weight to each claim.

As to the appropriately allowed student loan claim, I conclude that the allowable claim is that of Great Lakes Higher Education Corp. The parties agree that Payco is the assignee of the claim for collection purposes. Great Lakes has filed a proof of claim. The claim of Payco was filed by debtors' attorney. It cannot override the claim filed by Great Lakes.

IT IS ORDERED that the debtors' objection to the final report is sustained in part and overruled in part. The trustee shall amend his final report to provide distributions of assets in each debtor's estate, but he may not propose a distribution of estate assets which distributes assets only to Great Lakes Higher Education Corp.

IT IS FURTHER ORDERED that the debtors' objection to the trustee's final report as it regards the allowance of the claim of Great Lakes Higher Education Corp. and the disallowance of the claim of Payco American Credits, Inc. is overruled.

SO ORDERED THIS 6th DAY OF FEBRUARY 1998.

William L. Edmonds  
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order by U.S. mail to Judith O'Donohoe, Habbo Fokkena, and U.S. Trustee.